

**Welcome to the
presentation on
Study Manual (Chapter -
11)**

**- Non-current assets and
depreciation**

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Presentation outline

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- **Methods of depreciation**
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What is an Asset?

Asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

What is depreciation?

The systematic allocation of the cost or valuation of an asset less its residual value, over its useful life. In determining the expenses for a period, it is important to include an amount to represent the consumption of non-current assets during that period (that is, depreciation).

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To calculate the depreciation charge for an accounting period, the following factors are relevant:

Asset cost

Useful life

Asset residual value

Cost of a non-current assets

Directly attributable costs include:

Purchase price

Delivery costs

Stamp duty and import duties (and irrecoverable VAT on cars)

Costs of preparing the site for installation and assembly of the asset

Professional fees, such as legal and architects' fees.

Costs of testing whether the asset is functioning.

Useful life

The estimated economic life (rather than the potential physical life) of the non-current asset. The only asset that is deemed to have an unlimited useful life is freehold land.

Residual value

The estimated amount that the entity would currently obtain from disposing of the asset after deducting estimated disposal costs.

Methods of depreciation

There are several different methods of depreciation, of these, the ones which are relevant for Accounting are:

Straight line method

Reducing balance method

The straight line method of depreciation

The depreciable amount (cost less residual value) is charged in equal instalments to each accounting period over the expected useful amount of the asset.

The annual depreciation charge is:

(Cost of asset minus residual value)/Expected useful life of the asset in years

The reducing balance method of depreciation

The annual depreciation charge is a fixed percentage of the brought forward carrying amount of the asset.

When calculating reducing balance depreciation, the asset's residual value will not be considered or concerned with how to calculate the percentage: just the brought forward carrying amount and the reducing balance then apply the given percentage.

Calculating depreciation

Charge depreciation to income statement, and set up a balance sheet account called accumulated depreciation. When this is set against the asset's balance sheet cost account, we have its carrying amount

Depreciation may be calculated on the straight line basis:

$$(\text{Asset cost} - \text{residual value}) / \text{Months of useful life} = \text{Monthly depreciation charge}$$

Reducing balance depreciation:

$$(\text{Carrying amount} \times \% \text{ to be applied}) = \text{Annual depreciation charge.}$$

The depreciation method used should be applied

Calculation of Depreciation

When there has been enhancement expenditure, this would usually be depreciated over the remaining useful life of the whole asset.

The carrying amount of an asset should be reviewed and if there has been an impairment this impairment loss should be accounted for immediately.

If there is a change in the estimate of the asset's useful life or residual value, this too will cause a

Carrying amount

Cost less accumulated depreciation

Accumulated depreciation

The total amount of the asset's depreciation amount that has been allocated to accounting periods to date.

Accounting for depreciation:

DEBIT Depreciation expense (income statement)

CREDIT Accumulated depreciation (balance sheet)

Revaluation of non-current assets

The market value of certain non-current assets may change over time. The most obvious example of a rising market value is in land and buildings.

Journal entries for revaluation

When un depreciated freehold land is revalued upwards, the journal entry increases the asset's cost to the revalued amount and creates a revaluation account.

DEBIT	Freehold land - cost/valuation a/c
CREDIT	Revaluation account

When assets which have been depreciated are revalued upwards, we still increase the assets cost to its new value, but we also remove the accumulated depreciation that has built up to date. Together these amounts create the revaluation account:

DEBIT	Building - cost/valuation a./c
DEBIT	Building - accumulated depreciation a/c

Journal entries for revaluation

The asset's annual depreciation charge on the full amount after the revaluation is charged as an expenses in the income statement (the annual depreciation charge will rise after the revaluation):

DEBIT	Income statement - depreciation
on	revalued amount

CREDIT	Accumulated depreciation
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Disposing of non-current assets

A disposal account is used to calculate the profit or loss on disposal of an asset which is the amount by which the sales proceeds of the asset differs from its carrying amount at the date of disposal.

Accounting for disposals:

We record the disposal of non-current assets in a disposals ledger account.

The following items appear in the disposals account:

- (i) The value of the asset (at cost or revalued amount*)
- (ii) The accumulated depreciation up to the date of sale
- (iii) The disposal proceeds, if any

The profit or loss on disposal is the difference between:

- (i) The disposal proceeds and

Accounting for disposals:

The ledger accounting entries are as follows:

DEBIT Disposal account

CREDIT	Non-current asset cost account with the cost of the asset disposed of (the cost of the asset is removed from the balance sheet).
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DEBIT Accumulated depreciation account

CREDIT Disposal account with the accumulated depreciation on the asset as at the date of sale (the accumulated depreciation on the asset is removed from the balance sheet).

DEBIT Cash book (or receivables)

CREDIT Disposal account with the disposal

Accounting for disposal of revalued assets

DEBIT Revaluation account

CREDIT Retained earnings

The asset register

A listing of all non-current assets owned by the organisation, broken down by department, location or asset type, and containing non-financial information (such as chassis numbers and security codes) as well as financial information.

Data kept in an asset register

Details about each non-current asset include the following.

- The internal reference number (for physical identification purposes) for maintenance purposes.
- Description of asset
- Manufacturer's serial number
- Location of asset
- Department which uses the asset
- Purchase date (for calculation of depreciation)
- Cost and any enhancement expenditure
- Depreciation method and estimated useful life (for calculation of depreciation)
- Revaluation/ carrying amount

Intangible Assets:

Goodwill

If a business has goodwill it means that the value of the business as a going concern is greater than the book value of its assets less its liabilities. Goodwill is created by good relationships between a business and its customers, for example:

- By building up a reputation for high quality products or high standards of service.
- By responding promptly and helpfully to queries and complaints from customers.
- Through the personality of the staff, their attitudes to customers and their skills

Development costs

When development expenditure is carried forward as an asset the accounting entries are:

DEBIT Non-current assets

CREDIT Cash/Payables

Other intangible assets

A business may have other types of intangible asset:

Patents on ideas or designs that the business has developed or bought. These are used to generate income over many years. They are valued at cost and are subject to amortization in line with the business's policy, and to regular impairment reviews, which may result in an impairment loss.

Investments held for the long term. These may or may not be subject to regular writing down and/or revaluation, depending on their nature.

The non-current assets note to the balance sheet

There is usually a detailed note to the financial statements in respect of property, plant and equipment, with just the summarised figure in the balance sheet. For each class of property, plant and equipment the note shows:

- Cost and accumulated depreciation brought forward
- Additions during the year
- Disposals during the year, and the related accumulated depreciation
- Depreciation charge for the year
- Revaluations
- Closing balance carried forward
- **Note that disposal proceeds, and gains/losses on disposal, do not appear in the non-current**

